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Kirkland AIM

SEC Proposes Amendments to Advertising and Cash Solicitation Rules

17 December 2019

In November 2019, the SEC proposed amendments to its advertising and cash solicitation rules for SEC-registered advisers under the Investment Advisers Act.[1] If adopted, these proposed changes would significantly impact the marketing of private funds[2] by managers after a one-year transition period from the current rules. Among the proposed changes are:

- Implementing a "principles-based approach" to advertising content in lieu of some of the technical restrictions contained in the current advertising rule and numerous SEC no-action letters;
- Broadening and modernizing the definition of "advertisement";
- Permitting different track record information in advertising and diligence materials depending on whether the recipient is a Retail or Non-Retail Person (each as defined below);
- Permitting the use of testimonials, endorsements and third-party rankings in advertising subject to certain requirements;
- Requiring most advertising to be pre-approved by qualified adviser staff;
- Amending Form ADV to require advisers to identify certain advertising practices; and
- Requiring SEC-registered private fund sponsors to comply with the cash solicitation fee rule and amending such rule to apply to payments to solicitors (e.g., placement agents) in cash or non-cash consideration.

The proposed rules are subject to public comments, which must be submitted by February 10, 2020, and would not be effective until one year after the SEC issues any final rules.

Proposed Advertising Rule

New Definition of "Advertisement"

Advertisement Defined. The proposed advertising rule[3] would modernize and redefine "advertisement" to include any communication (e.g., print, internet, social media, email, text, television, or other broadcast medium, certain oral statements, etc.) that offers or promotes investment advisory services, by or on behalf of an investment adviser, to current or prospective advisory clients or investors in private funds. This new definition would apply to communications directed at a single recipient (e.g., emails or texts) unlike the current rule which applies to communications directed at "more than one person."

Attributing Communications to an Adviser. Whether a communication was made "on behalf of an investment adviser" is determined based on the facts and circumstances of such communication, but would usually include communications provided by an adviser to intermediaries (e.g., placement agents, consultants or third-party sponsors of feeder funds) for distribution to potential investors or to databases that are used by potential investors. Communications provided by an adviser to third parties could be considered "by or on behalf" of the adviser if the adviser was involved with the preparation of the information or explicitly or implicitly endorsed or approved the information. For websites or social media, the proposed rule would consider third-party content (e.g., by hyperlink) to be "by or on behalf" of the adviser if the adviser takes affirmative steps with respect to such content, including: (1) drafting, submitting or otherwise taking substantive steps in preparation of the content, (2) exercising ability to influence or control content (e.g., editing, suppressing, organizing or prioritizing content), or (3) paying for the content, whether in cash or non-cash consideration. The proposing release notes that third party or client postings on an adviser's social media page (including "like," "share" or "endorse" features) would not be considered "by or on behalf" of the adviser unless the adviser exercised actual control (e.g., deleting or reordering postings) over the content even if the platform allowed for the possibility of such control.

Certain Communications Excluded from Advertisement Definition. The proposed rule would exclude from the definition of advertisement[4] certain categories of communications previously interpreted through no-action letters as not subject to the detailed advertising rule with certain modifications as follows:

- *Responses to Unsolicited Requests.* Similar to the current no-action position, the proposed rule would allow an adviser to respond to informational or diligence requests that are initiated by an investor or prospective investor (i.e., a specific

request and not general "diligence" materials posted to a data room) without following the detailed advertising rule requirements. However, unlike the current no-action position, the exclusion would not apply to (i) any communication provided to a Retail Person that contains performance information[5] or (ii) any communication that includes hypothetical performance information. Therefore, the proposed rule may require an adviser to confirm the status of a prospective investor before responding to such a diligence request. To fall within the exclusion, the adviser would be limited to providing only the requested information and not additional information but may provide such additional information solely to ensure the materials provided are not misleading. In addition, the adviser may not make any affirmative effort intended or designed to induce the prospective investor to make the request or it will not qualify as "unsolicited."

- *Information Required by Statute or Regulation.* The proposed rule would exclude from the definition of advertisement any information required to be contained in a statutory or regulatory notice, filing or other communication, including Form ADV, Form D, Schedules 13D, 13G or 13F, or other information an adviser is required to provide to an investor under any state or federal statute or regulation. However, to the extent that an adviser adds non-required information that offers or promotes the adviser's services, then that information would be considered an advertisement under the rule.
- *Non-Broadcast Live Oral Communications.* The proposed rule would exclude from the definition of advertisement any live oral communication (e.g., phone call, in-person meeting or unscripted speech) that is not broadcast on the internet (e.g., social media, webcast or video blog), television, radio or any similar medium. However, pre-recorded communications (e.g., podcasts) and written materials (e.g., slides, scripts, etc.) prepared for any live oral communication are within the definition of advertisement, including for compliance review and approval.
- *Communications to existing investors; account statements and reports.* While the proposed rule does not explicitly address materials such as account statements or investor reports, the SEC indicated in the proposing release that it would not view a communication to existing investors, including account statements and reports that are intended to provide information about the investor's account and investments, as advertisements since such information is not typically used to offer or promote advisory services. However, just as under the current advertising rules, investor reports may cross the line into an advertisement if used for promotional purposes, such as using these materials with prospective investors or adding overtly promotional material to reports to existing investors.

A Principles-Based Approach

The proposed rule includes principles designed to prevent fraudulent, deceptive or manipulative acts in connection with adviser advertising. Specifically, the proposed rule[6] would prohibit:

- *Untrue statements or omissions.* The proposed rule prohibits any advertisement that includes any untrue statement of material fact or omits a material fact necessary to make the statements made not misleading.
- *Unsubstantiated claims and statements.* The proposed rule prohibits any advertisement that includes any material claim or statement that is unsubstantiated. This could include statements about guaranteed returns or claims about the adviser's skill or experience that cannot be substantiated.
- *Untrue or misleading implications or inferences.* The proposed rule prohibits any advertisement that includes an untrue or misleading implication about, or is reasonably likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to an investment adviser. This prohibition is intended to prohibit, among other practices, selective adviser favorable disclosures such as cherry-picking of performance or investments or non-representative testimonials.
- *Failure to disclose material risks or other limitations.* The proposed rule prohibits advertisements that discuss or imply any potential benefits from the adviser's services without clearly and prominently discussing associated materials risks or other limitations associated with potential benefits. This is intended to require an adviser to disclose downside risks if the adviser is also highlighting financial upside and gain. The SEC indicated that clear and prominent disclosure depends on the form of communication, but noted that merely linking to risk disclosure in a web link would not meet the clear and prominent disclosure requirement. However, requiring a person to be redirected to such disclosure before giving access to the positive information would meet such requirement.
- *Failure to present specific investment advice information in a fair and balanced manner.* The proposed rule prohibits references to specific investment advice when the presentation is not "fair and balanced," a concept borrowed from FINRA advertising rules and applicable to the regulation of broker-dealer advertising. This prohibition would replace the current prior specific recommendation provision which requires any specific recommendation performance information (e.g., multiples or IRRs for one or more investments) to be accompanied by at least one year of performance information for all other investments.[7] While such presentation would not be mandated, the SEC indicated that such a presentation would meet the fair and balanced standard. In any event, a fair and balanced presentation cannot just cherry-pick winning investments.

- *Unfair Presentation of Performance Results.* The proposed rule prohibits an adviser in an advertisement from presenting selected time periods or performance results in a manner that is not fair and balanced. This restriction addresses aggregate rather than individual investment information and addresses concerns over use of performance results that are not reflective of the adviser's overall results.[8]
- *Otherwise Misleading.* The proposed rule contains a general catch-all prohibition on advertisements that are otherwise materially misleading.

Advisers could violate the proposed rule's antifraud provisions whether or not the adviser intended to violate those provisions; the SEC would need only to show that an adviser acted negligently.

While the proposed rule's prohibitions generally are derived from the current rule's antifraud provisions (i.e., prohibiting untrue statements of material fact, or statements that are otherwise false or misleading), securities law requirements applicable to registered funds and broker-dealers and the SEC's examination experience with investment adviser advertising practices, the proposed rule's laundry list of principles arguably expands the reach of those provisions in certain contexts. For example, the proposed rule's prohibition on material claims that are unsubstantiated could apply to statements regarding an adviser's view of certain market opportunities requiring an adviser to substantiate such claims. It is also unclear whether the proposed "fair and balanced" standards are different from the current and proposed general material omission restriction. Also, the requirement to include risks when discussing benefits may require advisers to adopt more tailored risk factors in pitch books and other advertising like those used by broker-dealers and subject to FINRA rules.

In contrast, the proposed rule would also ease burdens on advisers in some respects. While the current rule prohibits advisers from distributing advertisements that refer directly or indirectly to past specific investment advice (unless such advertisements provide, or offer to provide, information about all of the adviser's recommendations during the relevant period), the proposed rule would replace that prohibition with a principles-based approach that would permit the presentation of past specific advice, provided it is presented in a fair and balanced manner. The proposed rule would also apply the fair and balanced standard to advertisements that provide lists of specific investments that the adviser previously recommended, in contrast to current relief that permits such lists, subject to numerous specific requirements.[9] In addition, while current SEC staff no-action relief permits advisers to include in advertisements investment performance achieved at a prior firm, subject to the satisfaction of numerous criteria, the proposed rule would not include specific requirements.[10]

Instead, the presentation of prior performance would be subject to the proposed rule's provisions regarding all advertisements.

Performance Presentations

New Specific Restrictions on Performance Advertisements. In addition to the principles-based prohibitions that would apply to all advertisements, including performance advertising, the proposed rule includes specific provisions related to the presentation of performance information in any advertisement and creates a new distinction between the information that could be provided to Retail Persons and to others. In general, the proposed rule would prohibit:

- presentation of gross performance to Retail Persons unless accompanied by net performance shown with equal prominence using consistent calculation methodology and time periods;[11]
- presentation of gross performance to any person unless the adviser provides, or offers to provide, a schedule of fees and expenses (calculated as a percentage of assets under management) deducted to calculate net performance;
- presentation of any performance information to a Retail Person unless the adviser shows performance of the same or related portfolios on a 1-, 5- and 10-year basis and ending on the most recent practicable date;[12]
- presentation of related performance (e.g., prior private fund IRRs and multiples) unless the adviser presents performance for all portfolios with substantially similar investment policies, objectives and strategies, subject to certain exceptions resulting in use of lower performance numbers;
- presentation of subsets of investment performance unless the adviser provides, or offers to provide, performance for all investments in the portfolio from which the subset was selected; and
- hypothetical performance (including targeted or projected performance) unless the adviser adopts policies and procedures and makes certain mandated disclosures.

The proposed rule's specific restrictions on performance advertising appear to have been targeted mainly at advisers to institutional and retail separate accounts and present some significant issues for private equity and similar fund advisers.

Retail and Non-Retail Persons. The proposed rule would create a new distinction between "Retail Persons" and "Non-Retail Persons" and would impose certain heightened performance standards on any advertisement used with Retail Persons. A

"Non-Retail Person" would be defined as a "qualified purchaser"[13] or "knowledgeable employee"[14] under the definition applicable to a qualified purchaser private fund, and a "Retail Person" would be any person other than a Non-Retail Person. This new distinction is based on the SEC's belief that Non-Retail Persons are generally in a position to bargain for, obtain, and analyze additional information when considering performance information, and that Retail Persons generally do not have such bargaining power or analytical ability.[15]

The proposed rule would require the disclosure of certain additional information to Retail Persons, and limit the information that could be provided to Retail Persons in certain contexts. For example, marketing materials presented to Retail Persons could include gross performance information so long as net performance is presented with equal prominence and the time periods and calculation methodology are consistent. It is not clear whether this restriction would apply to fund-level performance only or could restrict the use of a gross IRR and gross multiple for each portfolio investment without also showing investment-by-investment net returns.[16] Marketing materials provided to a Non-Retail Person could include gross performance without providing net performance, provided that the adviser promptly provides, or offers to provide, a schedule of the specific fees and expenses (presented in percentage terms based on actual expenses and assets under management) deducted (or that would be deducted) to calculate net performance.[17] Advertisements to Retail Persons that contain performance information would also need to include such information for 1-, 5- and 10-year periods (or inception if shorter) presented either on an individual account (e.g., fund) or composite basis (e.g., across funds). Advertisements to Non-Retail Persons would not need to include such information. Additionally, as noted above, an adviser could provide performance information without complying with the proposed specific performance requirements in response to an unsolicited request from a Non-Retail Person, but could not do so in response to an unsolicited request from a Retail Person.

For advisers to private funds, the proposed rule's distinction between Retail and Non-Retail Persons could result in different standards for communications to a fund's new prospective investors, or result in all communications being subject to the higher retail standard since advisers to private funds often would not know whether new potential investors are Retail Persons (i.e., accredited investors or qualified clients) or whether the potential investor is a Non-Retail Person (i.e., qualified purchasers) until after the investor has submitted an investor qualification statement which typically occurs after advertising materials are provided.[18] Likewise, private equity fund advisers may begin marketing a fund with the expectation that the fund will be available only to qualified purchasers, but, due to a variety of factors, the adviser later must open the fund to non-qualified purchasers. If such advisers did not begin with marketing materials

prepared for Retail Persons — despite the adviser's intention to market the fund to Non-Retail Persons only — the adviser could be forced to expend additional time and resources in order to revise its marketing materials for newly targeted Retail Persons. Finally, maintaining separate marketing materials for Retail and Non-Retail Persons would seem to be a significant burden for sponsors with a significant potential for compliance errors.

The proposed rule's requirement for Retail Advertisements[19] to present 1-, 5- and 10-year period returns when presenting performance is also not particularly well-suited to private equity or similar asset class returns (e.g., real estate, credit or infrastructure). Unlike the performance of hedge funds or mutual funds, the performance of private equity funds may vary substantially over the term of the fund, which generally lasts between seven and 12 years, with early years often negatively impacted by the "J-curve" effect. Therefore, private fund managers often will present no return data for the first year or so, designating such returns as not meaningful, provided no material negative events have occurred for the fund's overall portfolio. When the adviser offers serial funds but determines to provide composite (i.e., across funds) returns, the 1-, 5- and 10-year returns may also include investments from multiple funds in effect showing a blended return that was not likely achieved by investors in any private fund. Alternatively, using a 1-, 5- and 10- year return data on a fund-by-fund basis would require a new presentation format for most sponsors and would require potential updates to the latest date practicable during fundraising even if no material (or material to the downside) changes have occurred.

Finally, the schedule of fees and expenses required when showing gross performance may have limited utility for private equity and similar funds, particularly early in the life of the fund, and the treatment of certain elements of the calculation are unclear. In most cases, private equity and similar funds do not begin to generate returns sufficient to incur carried interest for a number of years. As such, the amount of a carried interest expressed as a percentage of the fund's assets under management would vary over the life of the fund from zero in early years to an amount approaching the full percent of profits potentially allocable to the adviser, which could be substantial. It is also unclear what fund expenses for a private equity or similar fund need to be included both in the schedule of fees and in calculating net performance, or how management fee offsets from monitoring or transaction fees would be factored in.

Related Performance. The proposed rule would condition the presentation of "related performance" ("the performance results of one or more related portfolios, either on a portfolio-by-portfolio basis or as one or more composite aggregations of all portfolios falling within stated criteria") on the presentation of performance of all related

portfolios. The rule would define related portfolios as those with investment policies, objectives and strategies substantially similar to the portfolio presented. The proposed rule would permit the exclusion of some related portfolios, provided the advertised results are no higher than if all related portfolios had been included. For private equity or similar funds, related performance could include (1) citing performance of predecessor funds, and (2) citing composite returns (e.g., track record across multiple predecessor funds).

For certain advisers to private equity or similar funds, the related performance criteria could raise a number of issues. For example, many advisers often pursue a single investment strategy in successive funds, each with similar investment policies and objectives. The proposed rule could result in such advisers being required to present the performance of all previous funds (either on a fund-by-fund basis or composite basis depending on the related performance triggering the requirement) any time related performance was presented.[20] Additionally, including the performance of an adviser's earliest funds may not be representative of more recent performance for a number of reasons, including that the markets in which many private equity funds invest are dynamic and likely to change considerably over time, because more recent funds may be substantially larger than previous funds, resulting in larger investments or more diverse investment portfolios and/or due to changes in the investment team over time. In addition, for private fund advisers with long firm histories, this requirement may make private placement offering materials and pitch books unduly long and complex.

Extracted Performance. Extracted performance is the presentation of a subset of a particular class of investments from a broader strategy. For example, a private equity fund adviser that has a diversified strategy may want to start an industry-focused fund in an industry sector where it has significant experience (e.g., health care, enterprise software, industrials, etc.) and may find it advisable to present its track record in that industry. Under the proposed rules, this is permissible so long as the adviser provides or offers to provide the performance information of the funds from which the extracted performance was derived. This type of presentation would also be subject to the other performance presentation requirements.

Hypothetical Performance, Including Targeted Returns and Projections. Under the proposed rule, an adviser's use of hypothetical performance, including targeted returns and projections,[21] would be permissible subject to safeguards against potentially misleading investors. Hypothetical performance could be provided to both Non-Retail Persons and Retail Persons but subject to the following requirements:

Policies and Procedures. The Adviser must adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the financial situation and objectives of the intended recipient, to ensure that the person has the financial and analytical resources to assess the hypothetical performance, and that the hypothetical performance would be relevant to the person's investment objective. In making such an assessment, advisers may rely on past experience involving particular types of investors (i.e., the assessment need not be made on an investor-by-investor basis). While it would be permissible to provide such information to Retail Investors, the proposing release notes a higher scrutiny would need to be applied in the context of Retail Investors, with a focus on whether such persons have access to analytical tools and other data to evaluate the information.

Calculation Information. The proposed rule would require an adviser using hypothetical returns to provide sufficient information to enable the recipient to understand the criteria used and assumptions made in calculating the hypothetical performance, including the likelihood of a given event occurring. This information must be given to all investors, including Retail Persons, although the proposed rule notes that the information could be tailored to the particular audience.

Risk Information. The proposed rule would also require an adviser using hypothetical returns to provide to Retail Persons, or provide or offer to provide to Non-Retail Persons, information to understand the risks and limitations of using the hypothetical information in making an investment decision.

While the proposed express authority to use targeted returns and projections would be welcomed by many private funds advisers, the proposed requirements would impose significant new hurdles for those advisers already including such returns and projections. Marketing materials, including private offering memoranda, are often provided to both Retail and Non-Retail investors. In particular, many real estate or similar asset class private fund managers may include projected returns together with historical returns. Also, many private fund managers will present target returns for the overall portfolio or fund. For co-investment vehicles for an identified investment, both projections and target returns may appear in offering materials. If adopted, the rules will make existing practices difficult to continue without significant changes to investor screening and to disclosure.

Testimonials and Third-Party Ratings

In a major shift from the current rule and previous SEC staff positions, the proposed rule would permit the use of testimonials, endorsements and third-party ratings in advertisements. To include testimonials or endorsements in advertisements, an adviser would have to disclose whether the testimonial was given by a client/investor or non-client/non-investor, and, if applicable, whether any compensation was provided by, or on behalf of, the adviser for the testimonial or endorsement. To include third-party ratings in advertisements, the adviser would have to reasonably believe the questionnaire or survey used in preparation of the rating was structured to enable favorable or unfavorable results with equal ease, and the adviser would be required to disclose: (1) the date of the rating; (2) the name of the party responsible for tabulating results; and (3) if applicable, whether any compensation was provided by, or on behalf of, the adviser for the rating.

Review and Approval of Advertisements

The proposed rule would require advisers to designate an employee to review and approve all advertisements, subject to certain exceptions. The proposed rule would exclude from the review requirement advertisements that are (1) disseminated only to a single person or household or to a single investor in a pooled investment vehicle; and (2) live oral communications that are broadcast on radio, television, the internet or any other similar medium. The designated employee should be competent and knowledgeable regarding the proposed rule's requirements, which generally means legal or compliance personnel, and should not be the same person who created the advertisement. Of note, the review requirement would apply to updates to any existing advertisement that was previously reviewed.

Form ADV Amendments

The proposed rule would require advisers to disclose in a new ADV Part 1A section[22] whether any of its advertisements contain performance results, and state whether any performance results included in advertisements were verified or reviewed by a third party. If the adviser included testimonials, endorsements or third-party ratings in any of its advertisements, that fact would also have to be disclosed, including whether the adviser paid or otherwise provided compensation for such testimonials, endorsements or third-party ratings. SEC staff would use this information to help prepare for examinations.

Amendments to the Cash Solicitation Rule

The current cash solicitation rule[23] regulates the payment of monetary compensation to persons who solicit advisory clients on behalf of advisers. Under the rule, an adviser must have a written agreement with a third-party solicitor and the solicitor must provide both the adviser's Form ADV brochure and a separate disclosure document detailing the solicitation arrangement to the client being solicited. Since 2008, the rule has been interpreted to not apply to private funds, including in connection with the use of placement agents. The proposed rule amendments would cover advisers to private funds and arrangements with solicitors, including placement agents. Other notable differences between the current rule and proposed rule[24] include:

- Application of the proposed rule to all forms of compensation (including directed brokerage, sales awards, training, entertainment, and free or discounted advisory services) subject to certain exceptions — and to both current and prospective clients;
- New disclosure requirements at the time of solicitation concerning any potential material conflicts of interest on the part of the solicitor resulting from the adviser's relationship with the solicitor and/or the compensation arrangement;
- Elimination of the current rule's requirements that the agreement between the solicitor and adviser require the solicitor to deliver the adviser's brochure and that the solicitor undertake to perform its duties consistent with the instructions of the adviser; and
- New disciplinary events that would disqualify a person from acting as a solicitor, including certain disciplinary actions by other regulators and self-regulatory organizations.

If adopted in its proposed form, the Cash Solicitation Rule would impose new burdens and costs on advisers to private funds using placement agents or other solicitors. The proposed rule would require advisers to private funds to enter into written agreements with solicitors,[25] prepare disclosure documents,[26] and maintain oversight of the solicitors such that the adviser has a reasonable basis for believing the solicitors have complied with the written agreements.

SEC Requests for Comment

Adopted rules frequently vary from proposed rules, including based on industry and other public comments, and the proposing release asks for comments on numerous aspects of the proposals. Comments on the proposed rules must be submitted to the SEC by February 10, 2020.

If you have any questions about the matters addressed in this *Kirkland AIM*, please contact the following Kirkland attorneys or your regular Kirkland contact.

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1. https://www.sec.gov/rules/proposed/2019/ia-5407.pdf↩

2. Recognizing that registered investment companies and business development companies are subject to advertising rules under the Securities Act of 1933 and the Investment Company Act of 1940, such funds are excluded from the proposed advertising rule.↩

3. Proposed Rule 206(4)-1.↩

4. Such communications would continue to be subject to the antifraud prohibitions of Section 206 of the Investment Advisers Act.↩

5. Performance information can be provided to Retail Persons, but only in accordance with the requirements of the proposed rule (described below under "Performance Presentations").↩

6. The proposed prohibitions replace the current rule's technical prohibitions (e.g., certain restrictions on selective recommendations, graphs, charts and formulas and statements of free services).↩

7. Private fund managers investing in non-publicly listed securities often seek to comply with the current rule by listing comparable performance information for all investments in the same fund when highlighting the performance of one or more investments from such fund.↩

8. Unsolicited investor requests (as discussed above) are excluded from "advertisement" and, therefore, are outside this prohibition.↩

9. *See Franklin Management, Inc.*, SEC staff No-Action Letter (Dec. 10, 1998), in which the SEC staff stated that it would not recommend enforcement action where an adviser included in advertisements past specific investment recommendations, provided (1) the adviser uses objective, non-performance based criteria to select the specific

securities that it lists and discusses in the advertisement; (2) the adviser uses the same selection criteria for each quarter for each particular investment category; (3) the advertisement does not discuss, directly or indirectly, the amount of the profits or losses, realized or unrealized, of any of the specific securities; and (4) the adviser maintains appropriate records, which would be available for inspection by SEC staff. ↩

10. The SEC is requesting comment on whether it should adopt specific provisions related to the presentation of prior firm performance.↩

11. The proposed rule defines (1) gross performance as the performance results of a portfolio (e.g., funds with substantially similar investment policies, objectives and strategies) before the deduction of all fees and expenses paid in connection with the adviser's advisory services to the fund(s) and (2) net performance as the performance results of a portfolio after the deduction of all fees and expenses that an investor has paid or would have paid in connection with the adviser's advisory services to the fund(s). For calculation of net performance, the actual advisory fees charged across the funds/investors would be deducted except (a) the adviser may deduct a standard model fee if the resulting performance is not higher than using actual fees, (b) the adviser may use a model fee for the highest fee applicable to the intended audience, and (c) custodian fees may be excluded in many cases, which was intended for advisers to separate accounts where the clients often select the custodian.↩

12. A shorter period may be used if the strategy was started earlier than the proscribed periods.↩

13. As defined under the Investment Company Act and generally includes individuals and estate planning vehicles with $5 million or more in investments and other entities with $25 million or more in investments.↩

14. As defined under the Investment Company Act and generally defined as senior-level executives and investment personnel.↩

15. The SEC is requesting comment on whether defining "Non-Retail Person" as "qualified purchasers" and "knowledgeable employees" is appropriate.↩

16. Current practice for most private fund advisers is to provide investment-by-investment gross returns but only net fund-level performance. Computing net returns on an investment-by-investment basis requires complex calculations and assumptions regarding the fees (including carried interest) and expenses to be allocated to such investments.↩

17. The proposed rule would require this new schedule to be prepared any time gross returns are presented, presumably even if net returns are actually presented (e.g., for Retail Persons).↩

18. As noted above, Non-Retail Persons would also include knowledgeable employees with respect to qualified purchaser funds.↩

19. Advertisements presented to Retail Persons.↩

20. As noted above, the proposed rule would allow earlier funds to be excluded if excluding such funds would result in a lower returns being presented for later funds or composite number.↩

21. In addition to targeted returns and projections, the proposed rule on hypothetical returns would cover back-tested returns (applying a new strategy or model to investment results that occurred before the strategy was developed) and model or representative returns (paper trading done contemporaneously but without actually trading client funds). Both types of hypothetical returns are generally only used by managers of liquid securities with market prices. The proposed rule would be a change in the SEC's historical concerns that back-tested returns could be inherently misleading.↩

22. The proposing release does not indicate whether the new section would require an amendment only in connection with an annual update.↩

23. Advisers Act Rule 206(4)-3.↩

24. In addition to the current rule's exceptions for (1) impersonal investment advice and (2) in-house solicitors and other affiliated solicitors, the proposed rule would add (3) de minimis and (4) non-profit programs exceptions.↩

25. Such agreements would (1) be required to describe with specificity the solicitation activities of the solicitor and the terms of the compensation for the solicitation activities; (2) require that the solicitor perform its solicitation activities in accordance with the Investment Advisers Act antifraud provisions; and (3) require and designate the solicitor or the adviser to provide an investor, at the time of any solicitation activities or, in the case of a mass communication, as soon as reasonably practicable thereafter, with a separate disclosure document meeting the conditions of the rule.↩

26. Such disclosure documents would be required to include (1) the name of the investment adviser; (2) the name of the solicitor; (3) a description of the adviser's relationship with the solicitor; (4) the terms of any compensation arrangement, including a description of the compensation provided or to be provided to the solicitor; (5) any potential material conflicts of interest on the part of the solicitor resulting from the investment adviser's relationship with the solicitor and/or the compensation arrangement, and (6) the amount of any additional cost to the investor as a result of solicitation.↩

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